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Recommendations for the RCSA Finance and Investment Sub-strategy

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Robert Myers, February 16, 2001

I. INTRODUCTION

1. This note suggests an RCSA Sub-Strategy for encouraging increases in the volume and efficiency of private investment and investment financing within SADC. The primary focus of the Sub-Strategy is on four activity components that RCSA can initiate and support that will further the fulfillment of the overall RCSA Strategic Objective (SO 2) of "Increasing SADC Regional Market Integration". This Sub-Strategy applies to the achievement of RCSA's Investment and Finance Intermediate Results IR 1.2 (Investment Barriers Reduced) and IR 1.3 (Use of Financial Services Increased) that are an integral part of achieving SO 2.

2. Currently there is an agreed-upon SADC Trade Protocol aimed at reducing/removing all Intra-SADC trade barriers. Agreement on a draft Investment and Financing Protocol is languishing "on hold," apparently because it is seen as being "too tough" on heavily protected existing and/or planned investments in various SADC countries. In fact, an investment liberalization "protocol" is implied by the existing Trade Protocol, assuming the Trade Protocol is to result in increased welfare within SADC. That is, any gains in consumer welfare derived from freer trade within SADC can only be "financed" by greater specialization of production or investment efficiency, assuming an absence of grants from abroad.[1] Because of this, it is not necessary for RCSA to await SADC-wide agreement or an investment and finance protocol. The desired essence of an RCSA investment and finance sub-strategy is instead dictated by the intent of the SADC Trade Protocol.

3. **The Overall RCSA Goal for SADC** is to "promote equitable, sustainable economic growth in a democratic Southern Africa". Viewed purely from an economic standpoint this statement means the following. More economic growth requires more market integration and competition and increases in (private sector) employment and labor productivity. These in turn require more private investment and more mobility of labor and capital within SADC. More sustainable growth involves more appropriate, evenly applied, environmentally inspired regulations & abatement procedures throughout SADC. It is crucial for the other goals that democracy entail greater protection of minority and individual freedoms, including particularly the minority freedoms of *potential* investors and workers.[2]

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[1] External loans to public sectors are rarely welfare increasing and are therefore not considered. If intra-SADC trade liberalization is to be **creating** rather than **diverting** it must be accompanied by more efficient production/investment. In the absence of more grants from abroad, that is, assuming a zero BOP deficit, the trade protocol will only improve welfare if there is more generalized consumption and more specialized (efficient) production. It is the latter that is the purview of the implied investment and financing protocol.

[2] Hayek, Friedrich A. von, The road to serfdom. 50th anniversary ed., Introduction by Milton Friedman: University of Chicago Press, Chicago, IL, 1994.

4. **RCSA's SO 2** RCSA's Strategic Objective No. 2 (SO 2) is to enhance regional market integration. The more integrated the private sectors of SADC countries are, the more trade, and labor and capital movements there will be within the Region. In most SADC countries, private sector integration requires less not more public sector action. As a general rule internal and external trade rise together.[3] More free (private) trade within SADC will lead to more external trade from/to the SADC region. The watchwords of SO 2 are liberalization and harmonization of private economic activity. If successful, these will lead to significant increases in investor competition and outsourcing within SADC. In this context more investor competition that leads to more outsourcing is the route by which many of the benefits of closer association can be created and spread.[4]

5. An underlying presumption is that policy reform, harmonization and credibility[5] are more important than resource transfers in achieving SO 2.This is primarily because an appropriate, harmonized and credible policy atmosphere will engender large, probably sufficient increases in domestic savings and investment. In such a setting, relatively large resource transfers from abroad to public sectors can be counterproductive. Such transfers alter (depress) private saving and investing motives, thus "crowding out" private saving/investing initiatives. This crowding out effect is particularly pronounced if the external resource flows to public sectors are in the form of loans (even if subsidized) rather than grants. This is because external loans to public sectors usually have to be repaid with taxes on the private sector

6. **Adequate Financing is NOT a Concern** The supply of financing will accommodate to increased investment demand. For this reason, this Sub-Strategy focuses almost exclusively on raising investment demand. Forcing increases in the supply of credit does not create an increased demand for investment credit.[6] In the past it was reasoned that investment in developing countries was constrained by a lack of investment financing. This shortage was in turn thought to be due to underdeveloped financial systems and a poverty-related lack of domestic savings. Expanding investment was, therefore, seen purely in terms of increasing the quantity of (cheap or free) resource transfers from abroad. In effect economists were reasoning that an expansion in the supply of (cheap) investment financing from abroad would "push up" investment levels and GDP growth. As a general rule, this approach resulted in an expansion of credit-financed consumption rather than efficient investment.

7. A more recent, opposite view is that the lack of financial resources, domestic savings and financial development is mainly an incentive problem. In this view, the primary need is for investors to increase their demand for investment financing so as to

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[3] Ceglowski, Janet. "Has Globalization Created a Borderless World?" in Globalization and the Challenges of a New Century: A Reader, edited by Patrick O'Meara, Howard D. Mehlinger, and Matthew Krain, Bloomington, IN: Indiana University Press, 2000, pp.101-111.

[4] This is a point derivable from R.C. Feenstra, "Integration of Trade and Disintegration of Production in the Global Economy," JEP, Fall, 1998, pp. 31-50, and its references.

[5] Credibility is a frequently overlooked but very important element of policy reform. Without it, e.g., in Zimbabwe, policy reform doesn't successfully stimulate private investment. Scant research has been done on how to achieve reform credibility in developing countries. However, some work has been done on monetary policy in developed countries. See: Alan S. blinder, "Central-Bank Credibility: Why Do We Care? How Do We Build It?" AER, Vol. 90, No. 5, December 2000, pp. 1421-1431.

[6] In monetary policy circles, the phrase is, "you can't push a string". A corollary to this is that speeding the pace of financial sector development will not increase the levels or rates of return to private investment.

raise the private rewards for more saving and the provision of more investment financing. That is, a greater amount of domestic saving and investment finance will be forthcoming as investor demand for them rises. This is importantly due to the fact that an increase in investor demand will increase the earnings of those engaged in the provision of investment financing. The provision of more investment financing <u>is itself an investment, income earning activity</u> that is sensitive to the general investment climate. In effect, attention has shifted from administratively removing financing and savings constraints to adopting policies for increasing private investor demand for financial resources. The expansion of private investment should therefore be the primary aim of the SADC Sub-Strategy, since it will lead to an accommodating increase in financing.

8. This newer view, really an old view now reemerging, stresses that the supplies of savings and investment financing, and the greater development of financial sectors, are dependent on the expansion of private investment. The amounts of investment financing will accommodate to changes in investor demands. Greater private investment demand "pulls" the expansion of financing, but an exogenous expansion of investment financing can not "push" larger amounts of <u>efficient</u> investment. In this setting the major roles for public sectors are to adopt reasonable financial regulations and <u>participate in</u> the development of asset or capital markets. Such participation can take the form of buying/selling foreign exchange and financing public sector deficits through local currency bond sales. Otherwise, the focus of IR 1.2, to <u>reduce</u> barriers (administrative interventions) to private investment, is dominant.

9. In addition to this <u>INTRODUCTION</u>, this note contains three other Sections.[7] The Second Section (<u>II. INVESTMENT STATUS & BEST PRACTICES/PROCEDURES)</u> sets out in a series of sub-headings the present, generally applicable status of some important investment and finance parameters. Most subheadings also include indications of currently recognized best practices/procedures relevant to that subheading/parameter. The third short section (<u>III. PARAMETERS OF RCSA ACTIVITY COMPONENTS</u>), serves as a summarizing and organizing or transition section that links the best practices to the activity components set out in the fourth or <u>SUB-STRATEGY</u> Section.

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[7] The organization of this note is based on a December 26, 1999 Draft "Note on Preparing Sub-Strategies" by "Prog: SK Reddy. From the note it is clear that in addition to the Sub-Strategy section, the note should contain the Status and a Parameters sections.

II. INVESTMENT STATUS[8] & BEST PRACTICES/PROCEDURES

10. **Treat All Investors Equally** Foreign and domestic (SADC origin) invest**ors** are the same and should be treated equally. In addition, any invest**ors** should be allowed to arrange financing for their investments irrespective of the origin (foreign or domestic) of the financing. SADC country policymakers should be concerned mainly with the efficiency of investment, not the origin of investors and/or whether the investment financing comes from within or outside SADC. In other words, foreign investors should be attracted for their potential impact on growth in private, productive employment rather than for the BOP impact of any foreign investment (FDI) flows they engender. In the present context "attracting" appropriate private investors mainly involves less not more government administrative intervention.

11. It should be appreciated that private foreign invest**ors** who use domestic (SADC) financing sources to finance high yielding investments will provide high yielding domestic saving opportunities for SADC citizens and insurance and retirement institutions. Because of this, policies should favor all investment equally rather than favoring FDI. The same goes for the origin of investment financing. No particular sources of investment financing should be specially favored.

12. **Relative Price Changes Must be Allowed to Occur** Credible policy reform involves definitively eschewing price interventions and allowing relative prices to change in unknowable, unpredictable ways. SADC governments are loath to do this. They tend to keep their price intervention options open and to exercise them occasionally and capriciously to frustrate market clearing price movements. This reduces the credibility and effectiveness of whole policy reform agendas, no matter how well intentioned. At present there are some explicit price controls in most SADC countries, but, perhaps more important is the threat of the imposition of price controls if prices seem "too high" to policymakers. All SADC governments should credibly eschew explicit or implicit interventions to influence relative prices,[9] and dismantle explicit and implicit price control mechanisms.

13. Price interventions are not effective from the viewpoint of redistributing welfare or preventing inflation or monopolies. Price interventions mainly reduce general welfare by granting special favors, mostly to those not needing them, and increasing corruption and informal economic activity. Particularly counter-productive are SADC government proclivities to use price interventions to offset suspected monopoly excesses. That is, using price controls as an anti-trust measure. This practice, limits increased investment, production and competition, whereas what's desirable in monopoly situations is more investment, production and competition.

[8] Two good studies with recent, detailed country by country information on investment are: Research Report on Investment in SADC. By Dr. Peter Robinson (Zimconsult), dated March, 1998 done for SADC-FISCU, by Price Waterhouse, GOPA, Oxford International Group, Business Map & Zimconsult and C. Jenkins, J. Leape and Lynne Thomas (eds). Gaining from Trade in Southern Africa, [**including the annexes**] MACMILLAN PRESS, London, 2000.

[9] This dictum on non-interference does not apply to inflationary pressures. These must be addressed by the Central Banks, most appropriately under the aegis of the SADC Committee of Central Bank Governors (CCBG).

14. **Exchange Rates and Exchange Controls** Most treatises on investment and finance stress the significance, e.g., for attracting FDI, of correctly aligned and stable exchange rates and ease of currency convertibility. <u>In fact, these same characteristics are crucial for increasing investment by domestic investors.</u> In its more general form, the problem is reflective of <u>inadequate domestic asset or capital markets</u>. In the particular case of foreign exchange convertibility, the problem is the absence of free foreign exchange markets. Within SADC, this is due to the fact that governments (Treasuries and Central Banks) do not buy and sell foreign exchange in such markets (see forward in the discussion of asset markets). Instead the governments generally require that foreign exchange, or a portion of it is surrendered to Central and/or commercial banks (in external accounts).

15. If SADC Governments were to encourage development of foreign exchange markets by buying/selling foreign exchange, using domestic currency, there would be no need to establish "correct" exchange rates and to give currency convertibility guarantees. In addition, SADC country Central Banks could focus on controlling inflation by altering domestic (SADC) short-term interest rates, since capital would be freely mobile within SADC. Central Banks could then allow domestic price adjustments, importantly for financial and productive assets as well as final goods and services, so as to stimulate greater private sector investment/productive employment.

16. **Factor Mobility and Increased Private Investment** Crucial to achieving the benefits of greater regional integration is increased private sector investment. Integration and/or reform policies will ultimately be abandoned unless they stimulate greater private investment and employment. It is also necessary that the new private investment be more efficient, and preferable that greater investment come from a larger number of private investors, rather than be a small clique of "big men" who will act, or be tempted to act monopolistically. Until a few years ago, it was thought that free mobility of capital, but not labor, throughout a free trade area would maximize benefits. This was summed up in the phrase "capital is cheaper to move than labor". However, it is now recognized that free mobility of labor is essential to raising labor productivity and, therefore the returns to and the levels of private investment. Labor mobility also helps to spread the benefits of SADC more evenly amongst its citizens. It should be noted that greater, higher yielding private investment is compatible with more employment and constant or rising wages.[10]

17. **Creation versus Diversion** The tendency in discussing the benefits of association in Free Trade Areas (FTA's) and Regional Economic Groupings[11] is to talk in terms of creation versus diversion. What is desirable is creation, of trade and/or investment and productive employment. What is not desirable is diversion of trade, investment and employment. Diversion concerns efficiency of production rather than geographical location. It is undesirable if SADC policies lead to increases in production within SADC that is markedly less efficient than the production that is replaced from outside SADC. The consumers of the affected items will complain because they will have to pay higher prices. If the affected consumers are a powerful constituency, e.g., because they are mainly grouped in one SADC country, they will become a force for dissolution of SADC. Diversion can be horribly welfare reducing. This is demonstrated

[10] This assumes that wages are not absurdly high, e.g., due to protection, to start with.
[11] I'll mainly discuss SADC as a Regional Economic Grouping involving free intra-SADC mobility of goods, labor and capital.

by international reactions to beggar-thy-neighbor policies leading up to the Great Depression of the 1930s.

18. Creation is also concerned with efficiency or rates of return to investment, before and after the SADC protocols are effectively implemented. If SADC-inspired liberalization and harmonization appropriately raises rates of return to investments within SADC, e.g., so as to increase competition, investment <u>and</u> lower per unit production costs, then the additional investment/employment is "created," not "diverted". Real income increases in SADC will outpace relative price increases so that SADC, considered as a whole, will be better off. A major implication of these last two paragraphs is that SADC policies must result in increased productive efficiency within SADC, not diversion of economic activity from areas with higher productive efficiency.

19. **The role of Competition** A remarkable advancement in development policy awareness has come from a decade of studies investigating the growth and convergence of total factor productivity (TFP). These studies are aimed at analyzing differences in, and convergence of TFP growth between industrial sub-sectors and industrial countries. They suggest that, given some policy prerequisites, TFP grows and grows faster the more producers face competition from new actual or potential investors.[12] I will call this "investor competition" and assert that <u>competition increases as the number of separately owned plants/businesses increases.</u>[13] This has led to a new appreciation of Joseph Schumpeter's concept of Creative Destruction[14] and to the enlarging of anti-trust agendas.[15] The implication of these points for SADC is that the more SADC protocols foster competition, particularly involving larger numbers of owners/investors, the more likely that efficient or "creation" investment will grow.

20. A crucial corollary to this is that governments need do very little, other than enforce enlightened anti-trust policies, to ensure <u>increased social welfare.</u> Private investors will expand employment and social welfare as long as they operate in an atmosphere of fierce private investor competition. This implies that SADC Governments generally reduce their administrative involvement in the economy, although expanding appropriate anti-trust capabilities is also essential. Another important implication of this is that Governments NOT attempt to influence the essence and/or location of private investment within SADC. To do so will lead to dissolution, a la the former East African Common Market.

21. **Compensation Issues** The gains from creation may, at any point in time be unevenly distributed across the SADC countries. Liberalization and harmonization may lead to an increase in efficient investment and employment in country **X** only. If so, country **X** would become better off relatively speaking than country **Y**, also in the regional grouping. In such situations the tendency is for the Government in **Y** to either adopt protective policies, thus contravening an investment protocol, or demand a share of

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[12] See, Eric J. Bartelsman and Mark Doms, "Understanding Productivity: Lessons from Longitudinal Microdata." JOURNAL OF ECONOMIC LITERATURE, Vol38, (Sept. 2000, pp. 569-594).
[13] This assumes that there are appropriate and credible anti-trust policies/procedures.
[14] See Peter Howitt, "Endogenous Growth and Cross-Country Income Differences." AMERICAN ECONOMIC REVIEW, Vol. 90, No. 4 (December, 2000) pp. 829-846.
[15] The Microsoft anti-trust case in the US is less about lowering output prices and more about increasing R&D expenditures and the pace of innovation.

the increase in benefits as "compensation. " Such compensation would normally come in the form of a transfer from Government **X** to Government **Y**.

22. However, it is not clear that such "compensation" is fair or economically sensible. It is not fair unless the investment in country **X** makes some in country **Y** absolutely (not relatively) worse off. Furthermore, the compensation may have asymmetric incentive effects in that it reduces private welfare in **X** while increasing public sector revenue in **Y**. Even worse, the "compensation" may essentially reward Government **Y** for continuing bad investment policies so that it can get more compensation in the future. When it comes to compensation, it is better to first allow the free market to correct things, e.g., through labor mobility and regional price and wage variations. Beyond that, it is important that those who are absolutely (not relatively) harmed, rather than their governments, actually get the compensation.

23. **Some Characteristics of Investment[16] & Investors** The term "investment" is an inclusive term encompassing all of the following: Foreign Direct Investment (FDI); Domestic Investment; Portfolio Investment (foreign or domestic); Real Investment; Financial Investment; Investment in Tradable Production; Investment in Non-Tradable (Services) Production; and Investment in Agriculture or Industry or Services. If there are improvements to the investment and competitive climates all, rather than some of these will rise. Saving and investing motives of investors are the same the world over. In particular, it is useful for policymakers in each SADC country to remember that country specific incentives aimed at attracting foreign investors will discriminate against their own investors, but favor investors from other SADC countries who are "foreign."[17]

24. Investors always seek protection from competition from other investors. If the sought-after protection is granted, domestic investment will be lower and output prices higher that they otherwise would have been. Investment in an international or competitive business climate usually increases employment and/or labor productivity. As a result, competitive investment usually increases wage bills or worker incomes. Investment in services tends to have the greatest (and cheapest) impact on employment and wage bill growth. However, it tends to have the least beneficial impact on the BOP and on public sector revenues. Structural unemployment is usually an indication that the domestic investment climate is not competitive.

25. **A Negative View of Investors** As a rule, policymakers and governmental administrators in SADC countries are, to a greater or lesser degree wary of investors. Investors tend to be seen as necessary evils that must be prevented from price gauging. Hence the preoccupation with price interventions. Investors are generally seen as likely to pray on innocent consumers/workers. This view leads governments to unsympathetically monitor and control investors so as to "protect" innocent consumers and laborers. This usually leads to more unemployment and welfare losses for consumers. Investors are generally seen as a distinct breed who will not compete against one another. For this reason, there is no belief that competition and market forces will bring consumer prices down to the lowest possible levels.

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[16] An excellent and complete treatment of investment issues in SADC is Dr. Peter Robinson's Report on Investment in SADC. A complete reference is contained in footnote 8 above.

[17] I evaluated some World Bank Structural Adjustment operations that established similar foreign investor incentive schemes in Kenya, Tanzania, Zambia and Uganda. It was found that most of the foreign investors who took advantage of the incentives in any one country came from the other three countries.

26. This negative ethos countenances significant intervention to limit the number of investors so that they can be carefully monitored and controlled. It frustrates all but a few investors who are favored, but must give favors in return. It is antithetical to competition amongst investors/producers and also **in**consistent with the fair and effective application of anti-trust activities. Instead, it encourages corruption.

27. **Problems with Rent and Corruption** Character weaknesses are not the cause of corruption. Corruption occurs because incorrect economic incentives stimulate rent-seeking rather than productive behavior. Investment barriers prevent intra-SADC competition thus limiting investment and growth in employment and GDP. With protection (monopolies), production is artificially restricted to make prices "too high."[18] The difference between the (higher) protected and (lower) competitive price, multiplied by the (restricted) output constitutes what economists call "rent". Rent is unfairly earned and not clearly deserved. It can therefore be appropriated or stolen with impunity for use for corruption, or excessive taxes, wages and resource consumption. Smart, entrepreneurial people, though more risk-tolerant than savers, will always attempt to minimize risks when seeking income. This leads them to seek rent rather than invest in more risky, but welfare increasing productive endeavors. When smart, potentially productive people expend their energy seeking rent, they are not contributing to economic development.

28. Because rent is created by restricting rather than promoting competition, policies enabling the creation of rent are destructive of welfare.[19] Conceptually investment barriers create rent that sustains infant industries through teething periods. In actuality, such barriers create rent that is appropriated by highly qualified people who, with an appropriate incentive system, would contribute greatly to development. The cure for corruption is unfettered competition. Policymakers must be convinced, frequently against their immediate interest, of the damage that government barriers to individual saving and investment desires do to competitive incentives and development. The vast majority of corrupt individuals would earn more legitimate income over, say, a ten-year period through economic growth than they will earn through corruption that prevents it.

29. Corruption is the scourge of efficient investment. If the corruption is "grease" it will enable some investors to by-pass barriers and make investments that they otherwise wouldn't make. However, such investments <u>will not be</u> <u>efficient.</u> The bribes are themselves costs and they actually reinforce rather than remove barriers to competition from other investors. Inevitably corruption that is "grease" turns to "glue" that prevents other competitive investments. Eradicating corruption involves growth in legitimate employment opportunities that in turn demands increased investment. In addition it requires free market competition and transparency or publicity, which are the enimies of corruption. The chances for corruption decline as government intervention into the trade and investment regime declines, and competition increases.

30. **Obsolete and Costly Customs Departments** Historically, Customs Departments were a crucial element of public finance and implementation of economy-wide protection policies. However, they have now become a primary hindrance to effective

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[18] Excessive protection or monopoly restrictions are indicated when firms within SADC are making profits while operating (very inefficiently) at low levels of capacity utilization.

[19] Footnote this- Anne Krueger.

policy reform and to increased, more competitive investment. Customs Departments no longer efficiently provide public sector revenue. Their corruption and capriciousness markedly suppresses investment, particularly by new, more efficient investors who would compete out the scarcity premiums garnered by existing, monopoly investors. It is these scarcity premiums, or rents, that are the object of pursuit of corrupt Government Officials, including those in Customs Departments. Because of this, Customs Officials fight reforms that would reduce the intransigence of Customs Departments.

31. Basically extensive computerization in most of the world's export producing factories, and by exporters themselves, and cheap, quick communications have made traditional customs functions and officials obsolete and unnecessary. In most developing countries it is probable that Customs Departments are 80% overstaffed, with most of the remaining 20% being **in**appropriately skilled.[20] Implementation of Customs Union protocols should force reductions in and rationalization and "internationalization" of SADC country Customs staff. Among other things, these staff will normally adjust their functions to reflect changes that de-emphasize traditional functions in favor of enforcing technical and environmental standards, that, like taxes, should be applied evenly across domestic production and imports alike.

32. **Stimulating Investment Demand Requires Deregulation** <u>Removing barriers</u> to greater private investment is crucial for expanding productive employment, GDP, domestic savings, investment financing and financial sector development. Deregulation within and across SADC countries is crucial. In short, less is more. There is a myriad of high yielding, efficient private investment opportunities within SADC. The presumption is that <u>excessive government interventions</u> constitute the major barriers to greater private investment. The key to the achievement of the overall SO 2 goal is therefore to <u>credibility reducing</u> SADC Government interventions into the economy. This process is more generally referred to as liberalization, but a more precise, behaviorally relevant term is **deregulation.** Proving the need for and implementing deregulation is a major focus of this RCSA Sub-Strategy.

33. **Creating an International Business Climate** The goal of deregulation is to create an <u>international business climate</u> within SADC. Such a climate is desirable because it allows <u>all</u> investors to increase employment and social welfare in the process of maximizing returns to investment. Creating an international business climate is <u>not</u> done to attract foreign investors. Instead, such an incentive climate within SADC will give more <u>domestic investors the chance to become internationally competitive.</u> The goal of deregulation is to make investors and investment within SADC internationally competitive.

34. **Formulating & Adopting Appropriate & Credible Policies/Procedures** Formulating and adopting appropriate and credible policies/procedures is a painstaking and expensive process. In particular, there is a vast difference between policy research that is <u>correct</u>, and policy research that is <u>convincing</u>. Correct policy research can frequently be done quickly, inexpensively and without much duplication. Convincing policy research, on the other hand is usually an expensive, duplicative and prolonged

[20] This is a point continually made by Mr. John Kugelman, former US Customs Official and now a consultant through Chemonics to Egypt's Ministry of the Economy and Foreign Trade.

process.[21] This raises questions regarding how to support policy research in ways that make it credible and convincing.

35. Issues relating to how to appropriately support convincing policy research are complicated, and essentially similar to issues relating to the support of R & D. Convincing policy research must occur in a competitive, but financially and professionally lucrative atmosphere. Someone's cost is someone else's income. As with R & D, there are incentive issues. It is most likely **in**appropriate for governments to directly support research regarding the best public-sector policies and practices applicable to them. However, indirect subsidies that stimulate private/academic funding of such activities can be successful. Probably least controversial are internationally proffered subsidies, e.g., through USAID, that stimulate more independent private/university funding of convincing policy research.

36. **A SADC Example** The correct investment policies for SADC countries are those that stimulate "open" or international business climates within SADC. These will lead to growth in investment that is efficient, measured in international terms. Such climates will stimulate <u>creating rather than diverting investments</u>. At present, most SADC government policies do the opposite: They <u>protect existing businessmen</u> against competition from potential new investors and from "cheaper" imports. The challenge is to do research that <u>convinces policy makers to discontinue policies that inhibit</u> more SADC-wide investment and trade.

37. Because of these protective policies/procedures, consumer prices within SADC will be <u>above</u> and total output or sales volume <u>below</u> what they would be under free competition. Both the too high prices and the too low volumes of output represent welfare losses resulting from government policies/practices that inhibit competition. Were these removed, more investors and laborers could produce more output and earn more income. At the same time, consumers would gain by lower prices and better quality output. The magnitude or value of these potential gains can be roughly estimated, at points in time, by using variations of Effective Rate of Protection (**ERP**) or Domestic Resource Cost (**DRC**) calculations.

38. A series of appropriately supported (e.g., by USAID, with SADC-wide participation/acquiescence) ERP/DRC studies within SADC would show rough orders of magnitude of <u>the huge opportunity costs</u> resulting from present government policies/procedures that inhibit investor competition. These opportunity costs are experienced as welfare losses by SADC consumers, and in terms of decreased investment and employment opportunities within SADC. Although the estimates are approximate, it is likely that credible studies would show unsupportable magnitudes of losses. These could convince policymakers to **deregulate** so as to increase participation by and competition amongst SADC investors and workers. Greater competition would, per force cause greater growth in consumer welfare.

[21] The time and cost of accomplishing convincing policy research is exemplified by the generation of best practices advice on Central Bank conduct of monetary policy. Research was mainly initiated by the Nobel Laureate Milton Friedman in the 1950s. A lot of money was spent, and income and reputations earned and lost over this policy issue. Much of the financing was from private/academic rather than government sources. Finally, after forty years, a convincing, generally agreed-upon set of best practice policies/procedures for Central Banks has emerged.

39. **Strategies for Implementing Deregulation** Since the 1980s, USAID, the World Bank and the IMF have been advocating relatively rapid, across-the-board, economy-wide liberalization or deregulation, in the guise of Reform or Structural Adjustment programs. For the most part, these programs have not been successful. This seems to be primarily because the liberalization or deregulation prescriptions, although perhaps correct, have not been convincing enough to offset governments' perceptions of the risks of rapid, economy-wide deregulation.

40. Much more objective research should have been done to try to convince governments to undertake these programs before they began to be advocated by Donors. However, it is not clear that such research would have been convincing. An alternative, suggested by the USA and Mauritius, is to **target deregulation**, either to particular economic sub-sectors (the US) or to particular geographical areas now known as Economic Processing Zones (EPZs-Mauritius). The attractiveness of this approach is considered in an article about Egypt.[22]

41. The article notes that targeted deregulation should consist of first achieving economy-wide macroeconomic stability and then targeting the dismantling of government interventions (deregulation) to particular geographical areas and/or within particular productive sub-sectors.[23] Targeting of deregulation allows a full reform package to be applied to a small economic area within a particular country or area. It can thus demonstrate the benefits of deregulation on the ground in a particular country/region. This markedly reduces reform risks. Once "reform kinks" are removed and the benefits of reform are clearly seen, the reform program can be applied to larger shares of the economy.

42. The employment and GDP growth gains from targeted deregulation can be significant and can convince policy makers of the desirability of extending the deregulation. Mauritius went from unemployment of 40% in 1975 to full employment by 1990. The impressive employment and output gains following deregulation in the US trucking, airline and telecommunications sub-sectors are documented in an excellent study by James Peoples.[24] The success of the targeted reform approach is compelling when compared with the rather dismal history of across-the-board, economy-wide liberalization or deregulation programs.

43. **Publicity, Transparency & Harmonization** It is likely that most of the increased benefits from SADC will not result from a greatly expanded internal market.[25] Instead, the gains are likely to come mainly if SADC leads to improved information flows, more policy/procedural conformity and consistency involving less intervention, a more outward-looking perception amongst policy makers and a sense of cohesion and belonging amongst all citizens within SADC. Information flows across SADC countries are probably somewhat worse than are information flows between the various SADC

[22] Robert Myers, "Economic Processing Zones Can Improve Economy-Wide Reform in Egypt," JOURNAL OF THE FLAGSTAFF INSTITUTE, Vol. 24, No. 1 (April 2000) pp. 22-50.
[23] Targeting to particular sub-sectors is preferable.
[24] James Peoples, "Deregulation and the Labor Market." JOURNAL OF ECONOMIC PERSPECTIVES, Summer, 1998; PP. 111-130
[25] This is a point made by Frank Flatters in "The SADC Trade Protocol: Impacts, Issues and the Way Ahead." DRAFT RAPID paper dated January 2001, p. iii.

countries and the outside world. However, the latter, especially as they affect investment, are also not well developed. An interesting question concerns whether to invest a sum of money on improving communications and information flows within SADC or between SADC countries and the rest of the world (ROW). It seems most likely that spending it to improve intra-SADC information flows would a) have a higher rate of return than to the ROW and b) have a bigger impact on rates of return to other investments in SADC.

44. **The Importance of Asset Ownership & Asset Transfers (Asset [Capital] Markets & Bankruptcy Procedures)** A crucial requirement for ensuring unfettered competition and maximum productive efficiency is that it be easy to transfer productive assets so that they gravitate toward those owners who will use them most productively. Such asset transfers occur most readily and efficiently through asset markets, but they can also be "forced" through bankruptcy proceedings. In talking about investment, the asset markets of most concern are **capital markets.** At present there are few formal asset transfer mechanisms in the SADC countries. Those that exist are "thin" and underdeveloped. Because of this, the process of placing the use of assets into the hands of the most efficient users is thwarted. In fact, within most of SADC the ownership concept is itself vague, importantly because the simplest indicator, the ability to sell assets quickly and inexpensively, is unavailable. Without asset markets, the designation of ownership, and ownership rights is subject to all sorts of political and legal interventions.

45. In developed countries major asset markets exist for land, houses, and financial and real, productive assets. These latter constitute the <u>capital markets.</u> Trading in real, productive assets now frequently involves stock markets in which ownership shares are bought and sold. In theory government <u>privatization</u> processes should stimulate the formation of asset (stock) markets, but most privatization procedures are really revenue raising exercises where monopoly privileges are the most valuable items brokered.

46. Strategies for stimulating development of asset or capital markets abound. The most sensible are those that emphasize <u>allowing the markets to emerge before adding (minimal) regulations.</u> However, advising on the subject is a growth industry, particularly as it applies to stock markets. In SADC countries the predominance of government ownership of land, infrastructure and productive capacity essentially means that governments must be willing to sell assets in nascent markets if they are to develop properly. So far, this willingness is in short supply. Historically, in more developed countries, <u>governments fostered the development of capital markets by buying foreign exchange and selling government bonds.</u> To a smattering of beleaguered economists, this still seems to be the most attractive way for SADC countries to hasten the development of capital markets and the deepening of financial systems.

47. **Tax Reform**[26] The SADC investment climate is negatively affected by several distortions in the tax system, but other problems, rather than tax issues, are probably more significant inhibitors of investment. The tendency in SADC countries, as in many developing countries is to try to <u>offset investment disincentives with tax/tariff breaks</u>. This is a <u>very inefficient, frequently ineffective approach</u>. It is also destructive because the tax breaks are usually <u>available to foreigners only.</u> With few exceptions, this

[26] This discussion s based on Z. Shalizi and L. Squire. <u>Tax Policy in Sub-Saharan Africa</u>, World Bank, Policy & Research Series, 1013-3429:2, 1988. I worked on drafts of this paper and so am familiar with it's background.

approach is quite costly to a country's welfare. It sets a precedent for discrimination against domestic savers and investors and mainly stimulates a few inefficient, diversionary investments.

48. If several SADC countries adopt this offsetting approach, but define "foreigner" as including other SADC countries, then it is likely that there will be quite a bit of (inefficient, welfare reducing) cross-country investment (see footnote 17 above on similar developments amongst Zambian-East African investors). The only worse approach that a SADC accord could do would be to define "foreigner" as applying only to investors outside of SADC.

49. Far better is to reform the tax/tariff system rather than try to offset disincentives. The reforms should be based on an assumption of **revenue neutrality**[27] and apply to all domestic and foreign savers/investors equally. Furthermore, they should be non-distortionary across all investment activities and should generate most of the tax revenue through taxes on consumption expenditures, be they for domestically produced or imported goods and services. If applied equally to imports and domestic production, such a sales tax on final consumption expenditures completely obviates the need for a tariff regime and customs, tariff collection departments.

50. Although it will help stimulate saving and investment if the reforms are the same SADC-wide, is not particularly important that the consumption tax rates (and each government's tax/GDP ratio) be harmonized.[28] Shalizi and Squire found that the thorniest fiscal issue affecting investment is the rate of expensing or depreciation each country selects. In general, the faster the better, but unlike the tax on consumption expenditures, harmonization of depreciation rates is important.

[27] This will put the focus on tax-induced distortions rather than on raising the tax/GDP ratio.
[28] See Jonathan Leape's chapter on taxation in Carolyn Jenkins, et al, Op. Cit. pp. 58-88.

III. PARAMETERS OF INVESTMENT/COMPETITION PROMOTION & RCSA ACTIVITY COMPONENTS

51. This short section serves as a transition between the above section on Status/Best Practices and the last, or Sub-Strategy Section. The basic presumption herein is that without simultaneous increases in private investment and competition there will not be adequate SADC-wide growth in employment and more equitably distributed income/GDP.[29] In a competitive atmosphere where there is no rent (ill-gotten or unearned gains), more private investors must provide other investors/workers with more income if they are to earn more income themselves. It is in this way, without the guiding hand of governments, that growth in private competitive investment leads to growth in social welfare.

52. In the five paragraphs below this one the parameters that affect growth in private, competitive investment are identified and discussed. One concerns **excessive economic interventions** by governments that constitute **barriers to competition**. These also establish an incentive atmosphere conducive to **corruption.** Reducing/removing these barriers requires greater **publicity, communications and transparency** in order to obtain SADC-wide acceptance of an appropriate policy/procedure menu. Crucial to convincing policymakers and gaining acceptance for such a menu will be the objective conduct of large amounts of **Policy R & D**. A second area that requires more, rather than less government involvement concerns **anti-trust or competition policy**. At present, SADC governments are too comfortable with allowing, but regulating collusive behavior. A third crucial inhibitor of growth inducing competition and investment is **the absence of competitive asset [capital] markets and of bankruptcy procedures**. Fourth and finally, there is a need to significantly **reform Customs Departments and Tax Systems**, SADC-wide.

53. As the Status Section (II) above shows, SADC country governments currently prevent growth in private investment by **excessive economic interventions** that erect barriers to greater competition and competitiveness. These interventions or barriers frustrate the saving, investment and work desires of large numbers of SADC citizens. A primary aim of RSCA and the SDDC secretariat should be liberalization, or the reduction/removal of these interventions or barriers to greater competition. This will enable expanded, more productive investment and reduce/remove the stimulus for **corruption**.

54. Reducing/removing interventions, or deregulation, that limit private SADC-wide saving/investment opportunities requires an enormous amount of **publicity, communications and transparency**. Effective policy reform must be agreed on and carried out publicly rather than in secrete.[30] Furthermore, effectively convincing policymakers to adopt a better and less invasive policy agenda also requires an enormous amount of **policy relevant R & D**, or relatively costly, seemingly duplicative policy relevant research applicable to SADC.

55. Only in the area of **anti-trust or competition policy** is it likely that more rather than less government initiative is needed. At present SADC governments exhibit too

[29] It will be recalled that the phrase "more equitable distribution" refers to the distribution amongst SADC-Wide **households**.
[30] This is a point that Jeff Sachs continually makes.

high levels of comfort and acceptance of collusive behavior. Since initial investors will always behave monopolistically unless prevented from doing so, inattention to the application of anti-trust policies/procedures leads to a self-perpetuating cycle. Limits on competition and opportunities to save and invest lead to monopoly behavior that rationalizes excessive regulatory or price control interventions. These, in turn discourage larger numbers of competitive investments. The adoption and credible enforcement of anti-trust policies and procedures is the major requirement for breaking this viscous cycle.

56. A most economically corrosive aspect of the SADC economies is the **absence of competitive asset [capital] markets and of bankruptcy procedures**. These shortcomings inhibit the application of monetary (stabilization) policy and the movement of productive assets to those owners/managers who can manage them most efficiently. The lack of competitive asset markets also leads to the adoption of contrived, ineffective exchange and interest rate policies and causes investors and providers of financial services (e.g., commercial banks) to shoulder excessive financial risks. These all markedly depress investment/productive incentives. Establishing bankruptcy procedures will require some institutional initiatives by SADC governments. However, the widening and deepening of asset or capital markets can best be encouraged by governments actively participating in such markets. In particular, governments can foster asset market and financial service development by agreeing to fully participate in markets where domestic currency is traded for foreign exchange and/or for domestic currency denominated infrastructure or public sector bonds

57. Finally, **Reform of Customs Departments and Tax Systems** is essential if competitive investment is to grow in the SADC region. Proper reform of tax systems would involve dropping any tax/tariff investment incentives and applying consumption expenditure taxes to all items alike, whether imported of domestically produced. In addition, expensing and depreciation must be speeded and harmonized throughout SADC. These tax reforms will make the revenue-gathering functions of Customs Departments superfluous, leaving those departments with primary function of testing and applying standards (for health, safety, the environment, etc.). These functions should be applied uniformly to imports and domestic production alike and are best and most efficiently applied following agreed protocols, SADC-wide. The implication of this is that individual country Customs Departments should essentially become units of a SADC administered testing and standards effort.

IV. AN RCSA INVESTMENT & FINANCING SUB-STRATEGY

A. Overview

58. The primary role of RCSA is to advocate, educate, cajole and convince the SADC Secretariat, its Committees and Units and SADC government policymakers to alter, mainly dismantle, existing policies/procedures so as to allow investment and investor competition within SADC to grow. A basic presumption is that policy reform, harmonization and credibility are more important than resource transfers in stimulating more investment and investor competition. It is assumed that investor competition will grow, as the number of separately owned plants/businesses grow. It is also assumed that because it is human nature to save, invest and compete economically, investment and investor competition will grow automatically once government-imposed constraints are lifted.[31]

59. RSCA's main tools for accomplishing this are **information, publicity, transparency and persuasion (moral suasion).** Resource transfers to governments and/or officials will likely have no, or a negative effect on the achievement of RCSA's SO 2 and IR 1.2 & 1.3. The main **leverage** that RSCA and the SADC Secretariat have is "**pressure to conform"** or a tendency for policymakers within SADC to emulate their brethren with respect to government investment and finance policies/procedures. Given the current (approximate) policy uniformity within SADC, it seems safe to assume that the SADC grouping makes up a cluster of public sector policymakers who are likeminded or simpatico with respect to public sector investment and financing policies/procedures.[32] Because of this, the basic approach is to change individuals through persuasion and then transparently publicize the changes and the results. This approach requires very close coordination with, and persuasion of the SADC Secretariat and SADC-wide committees/units such as CCBG and FISCU.

60. In the above, the roles of country-by-country research, communications and publicity and education/training of public officials are dominant. Hence the importance of one element of the first suggested activity component: The development of a free and open SADC **web site** that is co-sponsored and supported by the SADC Secretariat and its member Governments. A fundamental aim would be to reduce secrecy so as to inform private investors and convince public sector policy makers that less is more. That (frequently unsuccessful) public sector development policies and initiatives crowd out or suppress private initiatives that will more rapidly, efficiently and equitability develop the SADC region. The foundation belief would be in the freedom of working-age individuals to earn a respectable living.[33] A basic goal would be inculcate, in all working-age individuals, the belief that their income earning options extend throughout SADC rather than only within their country.

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[31] The increase in informal economic activity demonstrates this. There is a lot of investment in informal economic activity, much of it motivated by a desire to save, accompanied by a lack of credible and attractive official saving instruments. As with Tobin's Q, I assume that individual's motives to save and invest are indistinguishable. Savers are simply more risk-averse investors.

[32] The same motivational uniformity can be assumed to apply to potential private savers and investors across all SADC countries, and also throughout the world.

[33] In earlier times economists called this fundamental right, **"the freedom of calling."**

61. Why Should RCSA Focus on SADC? Greater competition in output and factor markets is the key to achieving more employment and more evenly distributed income growth. The traditional argument for Regional Economic Groupings is that their bigger size leads to more market competition and therefore more welfare. However, the SADC-wide market is still considered to be very small.[34] In addition, any SADC country that completely liberalizes its trade and exchange regimes has open access to much larger, more competitive world markets. This raises a question regarding whether there are additional benefits to liberalizing SADC as a whole instead of liberalizing each SADC country separately? The answer is "yes", for somewhat obscure but significant reasons. Because of these RCSA's and USAID's ultimate goal should be the complete liberalization of SADC.

62. One reason relates to endogenous or "natural" restraints to competition. The enemies of greater competition are restrictive economic policies/practices[35] and/or "natural market segmentations". The former, or the restrictions, are the target of any liberalization/deregulation effort. The latter, or "natural market segmentations" are quite common. They might be referred to as a "home bias" amongst SADC consumers, investors and workers. They also cause reduced competition and increased economic **in**efficiencies. Some possible explanations for these "natural" market segmentations are considered in a recent paper.[36]

63. What seems likely is that the formation and liberalization of Regional Economic Groupings will more effectively reduce such segmentations or "home biases" within SADC, as compared to country by country liberalization. With appropriate publicity, people's conception of "home" can be expanded, from a country concept to a SADC-wide one. If so, "natural market segmentations," will be reduced, encouraging more investor competition. A variation of the above economic argument is that political camaraderie and cohesion in regional economic groupings will bind potentially disparate policymakers to commit to a common liberalization path and pace.[37] It is these points, rather than the (not very much larger) size of the SADC market, that warrant a SADC-wide focus for RCSA.

64. SADC-Wide Goods and Factor Markets This strategy assumes that the current Trade Protocol will, over time, be interpreted so as to allow freer movement of goods within SADC. It further assumes that the nascent Finance and Investment Protocol will at least not prevent freer movement of private investment, investors and workers throughout SADC. That is, it is assumed that the two Protocols will be consistent with liberalization of SADC-wide markets for goods and factors of production.

65. Why the Heavy Emphasis on Stimulating Private Investment and Competition? Because the supplies of investment financing will accommodate to increases in investment demand (see paragraphs 6-8 above), this Sub-Strategy focuses almost solely

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[34] It is smaller than the Turkey market. See Frank Flatters, "The SADC Trade Protocol: Impacts, Issues and the Way Ahead." DRAFT RAPID paper dated January 2001, p. iii.

[35] These can be public or private. Tariffs, quotas and limitations on investment licenses are examples of public sector restrictions. Monopoly behavior constitutes private restrictive behavior.

[36] M. Obstfeld & K. Rogoff, "Six Major Puzzles in International Macroeconomics: It There a Common Cause?" NBER Working Paper No. 7777, July 2000.

[37] Frank Flatters, "The SADC Trade Protocol: Impacts, Issues and the Way Ahead." DRAFT RAPID paper dated January 2001, pp. 20 & 21.

on increasing the volume of private investment and competition amongst a growing number of private investors within SADC. If private investment and investor competition both grow within SADC, so will the demand for and potential earnings to the provision of financing. It is for this reason that it is said that financing will be accommodating to increases in investor demands. This Sub-Strategy assumes that shortages of financing will be avoided because increasing investor demand for financing will raise the income rewards to, and supplies of individual savings and privately provided investment finance.

66. **An Intentional Omission: Investment Promotion Programs.** In the past it was traditional to include a discussion of investment promotion or subsidies in investment strategy papers. This is no longer fashionable. Economies are now so open that most such investment promotion/subsidy programs "divert" rather than "create" investment flows. As such they contravene WTO agreements and invite disputes and/or retaliation. A crucial test of the contravention of WTO subsidy prohibitions is whether tariff-adjusted domestic prices are above fob export prices. If so, there is a presumption that inefficient domestic investors are receiving subsidies to enable them to export at competitive prices.

67. There are three sorts of investment promotion "schemes" that usually do not contravene WTO conventions. The best and least controversial is to achieve macroeconomic stabilization and liberalize domestic markets so as to stimulate investment and investor competition. The following quote from Nora Hill's chapter on Export Promotion Arrangements puts it nicely:[38]

> *"Generally investment (both domestic and foreign) responds to a sustained improvement in domestic economic fundamentals, and investors tend to be motivated by lower costs and higher efficiency of production."*

68. Beyond this there are a few investment promotion initiatives that fall into the category of offsetting distortions. The most usual and acceptable, such as duty drawbacks, specific tax breaks and tariff-free capital imports, offset distortionary tariffs and taxes. On the face of it, investment schemes that offset distortions do not contravene WTO conventions but they are not very efficient or successful. Worse, they tend to delay or proscribe liberalization, which is much better in the end. For example, proper tax reform is much more efficient at promoting competitive investment than offsetting measures.[39] It is also the case that offsetting subsidy programs can get very complicated to administer. If they become large and are used for extended time periods, they tend to invite retaliation, thus introducing countries to WTO dispute procedures.

69. Finally there is a class of investment subsidies that supports true infant industries. If legitimate, these mainly support R & D and/or innovation. Crucial to the success of these is that they be "lump-sum" (not recurrent cost) subsidies, that they be available to all potential investors on a competitive basis and that they cause increases in productive efficiency. Countries that have not yet liberalized and/or make heavy use of offsetting subsidies are very likely to end up facing disputes and retaliation if they try to make use of these sorts of subsidies. Because of the difficulty of properly administering

[38] Chapter 6, p. 132 in: C. Jenkins, J. Leape and Lynne Thomas (eds). Gaining from Trade in Southern Africa, MACMILLAN PRESS, London, 2000.
[39] This is a conclusion of a neat paper by Z. Shalizi and L. Squire. Tax Policy in Sub-Saharan Africa, World Bank, Policy & Research Series, 1013-3429:2, 1988.

these other investment promotion approaches, this paper takes the view that major emphasis should be placed on liberalization/deregulation.

B. Activity Components

70. There are four activity components listed below. They are called "activity components" in recognition that they are parts of an overall RCSA advisory and collaborative strategy. The approach of this SO 2 strategy is to induce or convince the SADC Secretariat, its constituent Committees and Units as well as the SADC Governments, by persuasion, publicity, estimates of possible gains/losses, etc. to adopt "best practice" policies and procedures. If adopted, these policies/procedures will increase the levels of investment and the competition amongst an ever-growing number of SADC investors. Greater, more competitive investment will in turn generate more employment and more evenly distributed income growth.[40] In addition, the more the investor competition, the greater the productive efficiency and the less the corruption. This will reduce resource use and the rate of environmental degradation associated with faster GDP growth.

Activity Component 1: Reducing/Removing Government Interventions & Corruption through Policy R&D, Policy Discussions and Publicity

71. This first activity component consists of four interrelated initiatives, involving constructing a web site and inventorying and dialoging on the removal of barriers, policy R&D, and advising on targeting deregulation to AGOA sensitive activities. The first of these initiatives is to construct and publicize an RCSA/SADC Secretariat Investment & Financing **Web Site.** It is crucial that there be **publicity and transparency,** or the open, honest publication of all information and RCSA/SADC interactions within and across SADC that are relevant to investment and financing (paragraphs 43 & 54). The more that investment-relevant information is easily publicly available, to investors and policymakers, the more private investment and investor competition will grow and the more likely that SADC governments' policies/procedures affecting investment and finance will improve and become harmonized. Effective policy reform is a public, not a secrete process. Given the magnitude of the publicity problems, it is most likely that an RCSA/SADC Web Site for Investment & Financing is called for. More important than the appearance of the web site would be it's impact on reducing secrecy so that reforms, or the lack thereof, that affect potential investors can be publicized. In view of way the Investment & Finance Protocol is being (very sensibly) based on prior experience with MOUs, it may be helpful help to get an MOU regarding the free and open operation of such a web site. Clearly there should be collaboration and coordination with the proposed expansions of the CCBG web site. A key indicator of successful progress would be the informational content of the web page rather than its appearance.

72. The second is to inventory, publicize & advise on removing/reducing country investment interventions. **Removing/reducing** government interventions in SADC countries will increase investment and investor competition, and through these will result in more employment and faster income growth (paragraphs 32 & 53). Some examples of harmful interventions are, explicit and threatened price controls, too high and/or

[40] The measure of income distribution being used here is the **size** distribution, or the distribution amongst SADC households.

unevenly applied tariffs and/or taxes, explicit (publicized) or implicit (capriciously, frequently corruptly applied) non-tariff barriers, restrictions on the issuance of investment licenses, etc.

73. SADC governments can get more investment, employment and social welfare by doing **less** rather than doing better and/or doing more. Viewed from this perspective, this element of this activity component should aim at convincing policymakers in SADC governments[41] that dismantling policies and administrative practices that inhibit new investment and investor competition will increase productive employment and GDP within SADC. It will help convince SADC governments if this element of this activity component is done in conjunction with the third element, or policy R&D discussed in paragraph 76 below. Indicators of success would include wide-spread public availability of the country-by-country inventories and of changes in them.

74. "Convincing policymakers" is crucial to the success of this activity component. This can best be done by a combination of intellectual interactions (one-on-one talks, seminars, etc.) and publicity. An approach that can work is to publicize the inventory and publicly identify "outlying" or quirky, country-unique trade and investment barriers. These should be the first targets of the dismantling effort. Following (publicized) successes in removing the outlying interventions, the goal could shift to convincing policymakers to reduce the remaining, commonly applied intra-SADC trade and investment barriers to a lowest common denominator.

75. The final stage would then be to lower the lowest common denominator to zero. In other words, to discontinue any remaining barriers to intra-SADC competition and to dismantle the remaining enforcement apparatus. Second, quickly harmonize the protection levels of the remaining investment barriers to the least restrictive (lowest common) denominator. Following this, agreement should be reached on how quickly to lower the common denominators to zero. Clearly a country by country inventory of investment barriers is needed to accomplish this.

76. The third element of this component is **Policy R&D.** This involves estimating and publicizing the size of transfers & costs of trade & investment barriers (paragraphs 36-38). These barriers cause domestic consumer prices to be above what they would be under free competition, thus earning the favored investor some "rent" on the (restricted) output sold domestically. This rent can be thought of as financial transfers (really cross-subsidies) that are paid by domestic consumers to the favored investor(s). The transfers are implicit rather than explicit because they are transferred directly from consumers to investors, thus bypassing the fiscal budget. It is possible to roughly quantify the size of these implicit transfers through Effective Rate of Protection (**ERP**) or Domestic Resource Cost (**DRC**) calculations. If a uniform ERP/DRC methodology is used across the SADC countries, the size of these barrier-related transfers, if publicized, can help convince policymakers to reduce/remove them. Similar methodologies can be applied across the SADC countries to estimate the efficiency losses that arise due to barrier-induced restraint of competition. These results too should be widely publicized and used to convince policymakers to remove intra-SADC barriers.

[41] Some attention might be paid to convincing country USAID Missions as well.

77. Fourthly, this component involves advising on targeting deregulation so as to promote AGOA sensitive investments. In a short chapter entitled, ""Export Promotion Arrangements"[42] Nora Hill makes the important point that the basis of export promotion is the expansion of more efficient domestic investment. The major inhibitors to increasing the efficiency of intra-SADC investment are government imposed barriers to competition. Hence the importance to investment promotion of the reduction/removal of trade and investment barriers, or deregulation. As Ms. Hill notes[43] deregulation is also the major way to promote investment in a WTO compliant way.

78. As has been noted above (see paragraphs 39-42) there are cogent reasons to expect that deregulation targeted to particular geographical areas (EPZs), or better still, to particular productive sub-sectors, is an excellent way to initiate SADC-wide liberalization. Targeting of deregulation allows a full set of reforms to be applied to a particular productive sub-sector. This reduces reform risks and allows the benefits of reform to be clearly seen so that the reform program can be applied to larger shares of the economy. Targeted deregulation should be particularly fruitful in conjunction with AGOA since this is based on expansion of particular sub-sector exports. Indicators of success would include an assessment of the extent of deregulation and the impact that it has on investment in the targeted (AGOA relevant) sub-sectors.

Activity Component 2: Introducing Anti-Trust or Competition Policies/Procedures

79. An activity component that convincingly advocates the establishment of expanded competition, or anti-trust capabilities within SADC seems essential. There is a tendency, particularly in Southern Africa to reason that anti-trust activity is superfluous because governments can impose price controls to prevent monopoly gouging of consumers. Unfortunately, this price regulation approach limits output, investment and competition and rationalizes the perpetuation of price control machinery. It is the opposite of good anti-trust policy, which aims to achieve lower prices by breaking up monopolies into several separately owned companies in order to stimulate more investment and production. Progress toward the achievement of this goal would be indicated by the establishment of different anti-trust policies/procedures that de-emphasize the use of price controls in favor of increasing competitive investment.

Activity Component 3: Building Competitive Asset/Capital Markets & Bankruptcy Procedures

80. This third activity component involves three related elements. The first is advising on the establishment of SADC-wide asset or capital markets (paragraphs 44-46). There are very few, mostly rudimentary asset markets in Southern Africa. Outside of South Africa there are virtually none. Most that exist are so "thin" that it is difficult to see them as being free and competitive. Furthermore, there is a pervasive lack of appreciation in Southern Africa of the significance of competitive asset markets both to provide service incomes and to stimulate private investment and investor competition. Without competitive asset markets it is nearly impossible to evaluate and very difficult to effectively change and the ownership of assets such as land and/or real and financial

[42] In the Book, Gaining From Trade in Southern Africa: C. Jenkins, J. Leape and L Thomas (eds), MACMILLAN PRESS, LTD, 2000.
[43] Ibid., pp. 132-134.

assets. A major problem is that "ownership" is poorly defined. Normally a key indicator of ownership is the ability to sell. However, without asset markets the definition of ownership becomes a legal nightmare. An addition problem in most of SADC is the overwhelming extent of government ownership of land and other assets coupled with an unwillingness to surrender this ownership, even though it would aid in the growth of capital markets and increase the amount and efficiency of investment.

81. The approach to be taken in this activity component is to advise SADC governments on how to carry out the following functions in ways that foster the development of SADC-wide asset markets.

i. Governments' purchase of foreign exchange;
ii. Governments' sale of local currency bills, notes and bonds to finance deficits;
iii. Privatization of Government provided goods & services--sales of assets & shares, outsourcing of services;
iv. Internal trade (CCBG) settlement mechanisms--note and bond sales; and
v. Harmonization of Financial Regulations.

Privatization, which could help establish asset markets and fragment ownership to help foster competition, seems to be seen mainly as a means of maximizing government revenue. The scant privatization that has occurred so far has been through non-market negotiations aimed at maximizing public sector revenue. Success would be indicated by increases in the open trading of currencies and financial assets, within and across SADC countries and the extent of progress in privatization of public corporations.

82. The second element of this activity component is to support CCBG efforts to appropriately regulate private provision of financial services. At present CCBG is primarily concerned with building and harmonizing Central Bank capabilities within SADC and with achieving a convergence of macroeconomic stabilization policies. Currently in abeyance is fashioning an appropriate, harmonized Central Bank regulatory role consistent with the expansion of private financial services. In truth, there appears to scant belief, either in CCBG or in the SADC Governments, that the private provision of financial services is feasible or desirable. However, the dismal, corruption-laden experience in most SADC countries with public sector provision of financing and financial services suggests the need for more Central Bank/CCBG attention/activity in this area. It seems crucial that RSCA and the SADC Secretariat join in supporting CCBG and it's member Central Banks to formulate and adopt both a pro-private sector stance and appropriate regulations and enforcement mechanisms that stimulate development of efficient, private financial services. If done in conjunction with Activity components **6** above, this can also stimulate increased private investment in life, retirement, disability and medical insurance activity.

83. The third part of this activity component is to advise on establishment of SADC-wide bankruptcy procedure (paragraphs 44 & 56). RCSA along with the SADC Secretariat should both foster the establishment of bankruptcy procedures and publicize the results of such proceedings. Successfully carrying out bankruptcy procedures involves the application of an eclectic set of skills. Successful bankruptcy proceedings like successful debt rescheduling, give "fair" compensation to creditors while preventing the rustication of potentially productive assets and the destruction of productive incentives. Some countries in Europe have separate sets of bankruptcy courts. In the US bankruptcy proceedings are monitored by normal court systems but bankruptcy "workouts" are done for the courts by separate teams of experts. The courts mainly ratify

these negotiated workouts. Progress in this area would be indicated by the establishment of bankruptcy procedures that are independent of governments and seen as being credible by private sectors.

Activity Component 4: Reforming Customs Departments and Tax Systems

84. The fourth activity component consists of two parts involving reforming SADC country tax systems *and* reforming and harmonizing customs departments. The importance of these is set out in section II above, mainly in paragraphs 30 & 31 and 47-50 above. While both elements of this activity component have significant impact on the amounts and efficiency of investment, each is usually undertaken as part of other activity initiatives. As a rule, the reform of Customs Departments is usually undertaken as part of Trade Reform Activity initiatives, even though customs irregularities have a significantly negative impact on investment incentives. Similarly, tax reform is usually the keystone of fiscal reform efforts. Unfortunately, when the focus of tax reforms is on raising the tax/GDP ratio, e.g., to close a fiscal deficit, the "reforms" may end up being more, rather than less distortionary.